

A report by:

THE JOINT LEGISLATIVE STAFF
TASK FORCE ON GOVERNMENT OVERSIGHT

Prepared for:

ASSEMBLY COMMITTEE ON CONSUMER PROTECTION,
GOVERNMENTAL EFFICIENCY AND ECONOMIC DEVELOPMENT
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CALIFORNIA



ONLINE LODGING

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*Has the State's entry into
the lodging reservation business
provided unfair competition to
California travel agents?*

An Informational Hearing

TUESDAY
FEBRUARY 3RD, 1998
10:00 A.M.
STATE CAPITOL
ROOM 447
SACRAMENTO

Findings

- The California Division of Tourism's \$2.5 million advertising budget, in part, promotes use of its toll-free telephone number and web site. Currently the web site features an on-line lodging system that allows the public to reserve and pay for rooms at some 315 hotels, motels, and inns. The 800-number callers are also able to pay for rooms by supplying credit card information to the operator. These lodging reservation services appear to put the state, at least in certain cases, in direct competition with California travel agents and tour operators.
- The Division is attempting to increase the number of hotels, motels and inns in the lodging reservation system.
- The Division does not verify the legal status of travel agencies listed on its web site and, in fact, some of these agents appear to be in violation of disclosure requirements specified by the Seller of Travel Law.
- Of the 315 places of lodging in the Division's reservation system, 47 percent are in San Diego. The Los Angeles area has only 13 hotels and motels listed.

Policy Questions Raised

The Division of Tourism's web site and forthcoming toll-free number raise numerous important policy questions for the Legislature to consider, including the following:

- Is it the appropriate role of the state to go beyond providing lodging information and referrals by serving as a booking agent for accommodations?
- Is there a sufficient gap in the lodging reservation marketplace that demands the state's entry?
- Is the state competing against private business?
- Do the state's actions have a chilling effect on the possible entry of new private enterprises into the lodging reservation business?
- Has the Division of Tourism violated provisions of the State Constitution that prohibit a gift of public funds?

Has the State's entry into the lodging reservation business provided unfair competition to California travel agents?

In December 1997, the state Division of Tourism added a controversial dimension to its web site (<http://gocalif.ca.gov>). Browsers now have the option of reserving and paying for rooms at over 300 privately owned places of lodging. This Internet feature was bolstered by a toll-free (1-800-462-2543) state telephone reservation system in mid-January, 1998.

Division officials have downplayed the 800-number system, stating that while operators are able to accept credit cards over the phone, such activity is not actively promoted. In brief, the Division wants to wait for the results of the February 3, 1998 hearing on this issue by the Assembly Committee on Consumer Protection, Governmental Efficiency and Economic Development.

Division of Tourism Director John Poimiroo calls the web site and toll-free number "essential electronic commerce." He says that within five years every state will be promoting tourism through central lodging reservation systems that rely on the Internet and toll-free numbers.

In the November 27, 1997, issue of *Travel Weekly*, Mr. Poimiroo also said the following about states which operate reservation systems: "They help relieve agents of the kind of less-profitable booking burden that they are trying to get away from."

In brief, many travel agents do not agree with Poimiroo's assessments. Agents call the Division's reservation program "unfair labor competition" and "an illegal use of taxpayer monies." "The state should not be competing with private enterprise," so charges Coranne Gibson, an Orange County travel agent and President of the California Coalition of Travel Organizations (CCTO) — the lead opponent of the central reservation system (CRS).

Since the web site was launched, travel industry groups, including the CCTO, have met twice with state officials to discuss how the CRS might be altered to remove objections. As of January 28, 1998, the CCTO remains adamantly opposed to the CRS web site and the toll-free number system.

When asked if a private organization might be able to operate a CRS on its own, Director Poimiroo replied, "They might, but we [the state] would do it best."¹ Mr. Poimiroo's remarks are at the heart of the CRS debate. The state may be the most effective "agency"

¹ Interview with John Poimiroo, Director, Division of Tourism, 1/16/98.

to represent all the places of lodging, parks, and commercial attractions which fuel California's \$58 billion tourism industry. But is the state's aggressive role in securing payments for private lodging fair to travel agents and tour operators? Furthermore, is the state's CRS, as currently fashioned, an illegal gift of public funds to those select private hotels, motels, and inns that benefit from the state program?

This report, prepared for the committee at the request of the chair, Assemblywoman Susan Davis, is intended to do the following:

- Explain how the Division's reservation system operates;
- Review perceived benefits and drawbacks to the system as well as possible unintended negative consequences; and
- Outline for committee members some of the key policy questions raised and to provide possible alternative solutions.

How The General Fund Is Linked To The Web Site

The Division of Tourism has a \$10,000 budget to maintain a web site which includes the reservation system function. The site was launched in 1994. The Division also has a \$2.5 million advertising budget (\$4 million proposed in FY 1998-99) which promotes use of the web site and toll-free number as ways to find out more about California attractions. However, as Director Poimiroo notes, the Division does not promote the CRS in its advertising, which targets people who live outside of California.

The CCTO considers the promotion of the web site a use of taxpayer dollars that benefits hotels listed in the CRS and, as such, it is a use that violates the State Constitution. (The Committee Chair has requested Legislative Counsel to issue a written opinion on the constitutionality of the web site and toll-free number prior to the hearing on February 3, 1998).

Mr. Poimiroo says that no state monies, other than maintenance funds, go to the direct operation of the web site that is managed by a commercial vendor, WorldRes, under contract with the Division. The vendor earns a 5 percent commission on each web site booking; i.e., the hotel must pay the vendor 5 percent of the room rate as a commission. When the vendor accumulates \$50,000 in commissions during one calendar year, subsequent commissions will be divided between the Division and WorldRes with the state earning 1.5 percent and the vendor, 3.5 percent, according to Poimiroo.

The commission structure for the toll-free reservation system differs slightly from the web site. In this case, the vendor, Bay Area Seating Service (BASS Tickets), earns 10 percent of each booking. When \$50,000 is accumulated in commissions in a calendar year, the state would then earn 20 percent of each commission paid to BASS.

Mr. Poimiroo says that any monies received by the state from the CSR will help offset costs associated with tourists requesting free travel planning information from the state.

The state's contract with BASS calls for the toll-free reservation system to be fully operational by March 1, 1998. BASS must maintain the CSR at its own expense and it is required to have live operators answering the telephone seven days per week (8:30 a.m. to 9 p.m., Mon.-Sat.; 9:30 a.m. to 9 p.m., Sunday).

The \$50,000 threshold may not be reachable in the foreseeable future since only 30 reservations were made during the web site's first month of operation. The low reservation rate is indicative of the fact that few people are aware of CRS. However, Internet bookings are rapidly becoming popular in the travel industry. For example, a major hotel chain recently reported that in just two years its Internet bookings jumped from \$100,000/month to \$2 million/month.

Mr. Poimiroo has stated that the low number of web site reservations was due to the fact that the CRS has not been promoted. But when asked about the constitutionality of using General Fund monies to promote the CRS, he notes that the CRS will not be mentioned in any Division advertising materials. The Division appears to be in a policy bind over fully implementing the CRS web site.

Finally, the booking commissions charged by the vendors under contract with the state appear to be within industry standards.

How hotels are listed on the web site

There are two ways for lodging business to be on the Division's web site:

- The business simply e-mails WorldRes, stating that it wants to be in the CRS. There is no registration fee, only the commission requirement for bookings. The business must enter a description of its facilities and post a photograph.
- A place of lodging with a home page URL can e-mail the Division so that the state's web site and the lodging's URL may be linked. The Division also offers California travel agents the same opportunity to link up with the Division's web site.

The toll-free number is the state's main line for providing travel planning information to consumers. Mr. Poimiroo states that "\$27 million in additional state tax revenues are generated by this Division program."²

When the toll-free line becomes fully operational for reservations, it would work in the following manner, according to Mr. Poimiroo:

² Letter from John Poimiroo, Director, Division of Tourism, to Richard Steffen, 1/16/98.

A potential tourist calls the state number, which is answered by an employee of the vendor. This employee is trained to talk about California attractions and to provide travel planning information. At some point during the conversation, the employee will ask the caller if he or she would like to make a lodging reservation. If the caller says “yes,” the operator transfers the call to a reservation specialist who would complete the booking transaction.

Benefits/drawbacks of a statewide lodging reservation system

- The reservation system is open to any place of lodging within California. Therefore, small inns, which cannot afford to advertise statewide, enjoy additional exposure when linked with the state’s web site.
- The California Hotel & Motel Association, which has been promoting the need for a central web site for the past seven years, represents many of these small, independent places of lodging. The associations’ executive vice-president, Jim Abrams, says that his membership companies, which compromise about 40 percent of the room stock in California, do not have the power of a central reservation system employed by the major hotels such as Hyatt, Marriott, and Holiday Inn. The state’s web site, therefore, is highly beneficial to the independent hotels and motels which, he says, typically are not on a travel agent's booking list. “The CRS simply does not compete with travel agents,” states Abrams. “They don’t do these types of bookings.”³
- Travel agents argue that any state action that results in a room booking is tantamount to taking potential business away from a travel agent. “Even if a small inn is not on my list, or does not pay a commission, I still want the right to provide services to clients who may want to stay at an out-of-the-way place — I don’t want to give up any portion of my professional service,” so states Coranne Gibson, the CCTO President.⁴
- Although Mr. Poimiroo says that the reservations system is not intended to take business away from agents, he acknowledge that “it is possible,” that some agents would lose business to the system.⁵
- Ms. Gibson also states that hotel bookings help agents meet monthly transaction quotas required for their free access to certain computerized commercial reservation systems. Therefore, even if a booking does not have a commission linked to it, the booking, itself, counts towards satisfying monthly transaction quotas.

³ Interview with Jim Abrams, Executive Vice-President, California Hotel & Motel Association, 1/15/98.

⁴ Telephone interview with Coranne Gibson, President, California Coalition of Travel Organizations, 1/8/98.

⁵ Interview with John Poimiroo, Director, Division of Tourism, 1/16/98.

- Mr. Poimiroo says the state system will list accommodations, such as commercial campsites, which are not found on travel agent reservation systems.
- Mr. Poimiroo also contends that the CRS is aimed at out-of-state residents who would not typically use a California travel agent. However, the Internet is easily accessible to Californians, so the Division is unable to prevent Californians from using the CRS.

Questions and considerations

- The listing of places of lodging on the web site includes only those establishments that have voluntarily chosen to be listed. Some hotel or inn owners may not know about the CRS. Other places of lodging may not want to pay a 5 percent commission for a web site transaction. *As of January 28, 1998, 47 percent of the 315 hotels, motels, and inns listed on the site were in San Diego County.* Los Angeles County had only 13 establishments listed. **Is it fair to all places of lodging that the state's CRS lodging list is not all-inclusive?**
- The Division says it will not accept listings from hotels, motels, and inns that have been the subject of consumer complaints. **How does the Division find out about complaints? How does it verify complaints? Does the Division have the regulatory authority to deny access to the web site?**
- Some places of lodging do not allow children, or cater to certain interests, such as X-rated motels. **Should the Division be promoting these places of lodging?**
- The web site allows users to link up with travel agents; however, the Division does not check the credentials of the agents — anyone may be listed. Some, but not all, of the listed travel agents appear to be in violation of disclosure requirements specified in the Seller of Travel Law. **Does the state have a responsibility to insure that travel agents are in compliance with the law prior to being listed on the web site?**
- Visitors to the web site or callers to a state toll-free number may have the impression that a state-listed hotel or travel agency has a “seal of approval” from the state. Businesses with image problems may promote that they are “listed with the State of California.” **Should the Division devise a consumer disclaimer regarding the state's relationship to the places of lodging listed in the CRS?**
- The State of New York's web site (<http://www.iloveny.state.ny.us>) directs browsers to call toll-free to the New York State Hospitality and Tourism Association, a nonprofit group, to make reservations. Also, browsers on the New York site may link up with hotels where rates and credit card information are advertised; however, a money transaction cannot be made via the site. **Should the transaction function of**

the Division's reservation system be eliminated? Should the Division refer site visitors to a nonstate reservation system?

- Some travel agents are more concerned with the toll-free line than they are with the Internet. What controls will be placed over a live operator who may pitch a certain hotel to a caller who is unfamiliar with the destination in question? Could this operator make “hints” about other places to travel during a transaction phone call? The Internet has the limits of the printed words and images as well as the consumer fear that cyberspace thieves may victimize a credit card number. **Has the Division structured its toll-free reservation system appropriately, or should modifications be made?**
- Existing law allows the Division to assist in the development of a user-directed, computer-based public-access information system that will meet the needs of travelers and tourists. This language may be too far-reaching for those who worry that the state will expand its travel agency-like services. **Should state law be amended to more clearly define the appropriate authority of the Division of Tourism?**